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SUBJECT: ZONE DEFENSE: DALIAN ADMINISTRATORS TELL USITC
WHAT WE ALREADY KNOW

REF: USITC/SHENYANG EMAIL 9/2008

¶1. (SBU) Summary: U.S. International Trade Commission (USITC) officers visited various development zones and companies (chiefly foreign-invested) in the port city of Dalian, Liaoning Province with the purpose of discerning the differences between the various zones and the benefits they provide to companies located in these zones. The visit suggested that Dalian's unique location, highly educated population, and developed infrastructure continue to be more important factors behind the decision to invest than any special benefits but that zone administration remains an important consideration. This cable reports on the views of the zone administrators, who were predictably cautious. A separate cable reports on the somewhat more frank discussions with representatives of companies (Intel, Epoch International, Neusoft, and Genpact) in each zone. End Summary.

¶2. (U) October 26-27 ConGenOffs accompanied USITC officers Alexander Hammer, International Economist at the office of Economics, Country and Regional Analysis Division and Michael Anderson, Chief of the Advanced Technology and Machinery to Dalian to find out more about the differences between economic zones in China. By Hammer's count, China has 208 national-level development zones and anywhere from 1,300 to 20,000 sub-national-level zones. (REFTEL) Dalian, Northeast China's premier port, is replete with such zones.

Dalian Development Authority (DDA)

¶3. (SBU) Hammer and Anderson met with Director of the Europe and America Office of the Economic and Trade Bureau of the DDA Chen Yuguang. Chen noted that in this, its 25th anniversary year, the DDA has grown from three square kilometers to over four hundred square kilometers having a population of 600,000. Ten thousand enterprises are located in the DDA, of which 3,000 are foreign-invested and 47 are "Fortune 500" companies. The enterprises are concentrated in the petrochemical, pharmaceutical, shipbuilding, auto parts, new materials, and IT and IC industries. In an effort to attract biopharmaceuticals and the LED industry, DDA administration officials often travel to Europe and the United States to interact with Small- and Medium-sized enterprise (SME) associations.

¶4. (SBU) According to Chen, the Value-Added Tax (VAT) rate for the DDA is the standard 17 percent and the corporate income-tax rate is 25 percent. (The DDA and the city of Dalian also levy their own fees as well.) About 75 percent of VAT revenues are remitted to the Central Government, while the rest goes to the city and the DDA. Some 60-70 percent of

the income-tax revenue is funneled to the Central Government, while the rest is split between Dalian and the DDA. A certain portion of these tax revenues is refunded to the corporations, and the percent refunded directly correlates to how much a company contributes to the tax base; i.e., a company with more revenue contributes more taxes and will therefore get a higher percentage refunded. The DDA and the city of Dalian use the remaining tax revenues to encourage the development of new industries in the DDA. Chen would not give more specifics on the preferential policies offered by the DDA. He suggested, however, that specific industries or "special projects" having major investment potential would receive special treatment and other tax incentives, noting that Intel's recent wafer fabrication operation was one such "special project." After speaking at length on various tax incentives offered by the DDA, Chen expressed concern about whether the questions posed to him were related to any recent anti-dumping actions.

Dalian Free Trade Zone (FTZ)

15. (U) At the 64-square-kilometer Dalian FTZ, Investment Promotion Bureau officials told the delegation that their zone was established in 1992 for the purpose of export processing, logistics, and bonded warehousing. Over 2,000 enterprises are now registered in the FTZ, the majority of which are foreign-invested. The FTZ is part of a specialized port area and a bonded port that features two crude oil terminals, a liquefied natural gas terminal, an iron ore terminal and a grain terminal. According to officials, by

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June 2011, the port will include one of only four specialized automobile terminals in China--the Jinzhou auto city--and will be devoted to automobile manufacturing and logistics warehousing.

16. (U) Because the FTZ is considered to be outside of Chinese customs territory, all transactions within the zone are exempted from VAT or consumption tax. The corporate income tax rate in the FTZ is 25 percent. Seventy-five percent of this tax revenue is divided between the central, provincial, and municipal governments. The other 25 percent goes directly to the FTZ administration. Among the benefits the FTZ offers are subsidized interest rates on bank loans for FTZ companies and rent-free warehouses for a new entrant's first several years of operation. Bureau officials stressed that most companies choose to operate in the FTZ due to its proximity and easy access to several key markets, including China, South Korea, and Japan, and not primarily because of these preferential policies.

Dalian Port Corporation (DPC)

17. (U) The DPC, a state-owned enterprise with total assets of RMB 30 billion, operates the Port of Dalian, the largest port in Northeast China and one of the top five in the country. Like the FTZ, the DPC has crude oil, grain, automobile and general cargo terminals, but the scale of operations is an order of magnitude larger. The main port facilities are much older than those in the FTZ, and it does not offer the same preferential policies. An estimated 75 percent of the Northeast's foreign trade and 90 percent of its import/export containers go through the DPC, which is also operates China's largest crude oil terminal (annual throughput capacity is 57 million tons). The DPC also operates China's largest dedicated iron-ore terminal, having an annual throughput capacity of 24 million tons, and China's largest dedicated car terminal, with annual throughput capacity of 780,000 units.

Dalian High-Tech Zone (HTZ) and Dalian Software Park

¶8. (SBU) At the HTZ, the delegation met with Executive Vice Director Wang Xianjin. Established in 1991 and covering 35.6 square kilometers, the HTZ is divided into nine separate parks, each of which has its own specific focus. Some of the parks are privately-owned, such as the Dalian Software Park, and several are still only in the planning stages, such as the Hekou Software Park. Three thousand companies are located in the HTZ, some 80 percent of which are foreign-invested. The majority of these are U.S. companies. One tenth of the enterprises are devoted to manufacturing, while the rest are devoted to services and R&D. Although many of the older companies are focused on business processing outsourcing (BPO), such as call centers, many of the newer companies are focused on KPO (knowledge processing outsourcing) and ITO (IT outsourcing).

¶9. (SBU) Wang claimed that his administration had studied carefully the outsourcing experience of Bangalore when developing the HTZ. Although he conceded that Bangalore has more IT training institutions and its work force has better English-language skills, the Dalian HTZ has invested heavily in infrastructure development to ensure the quality of its power supply, light transportation, and living facilities. When the HTZ was first established, the government supplied the administration with a development support-budget of only RMB 10,000, which has grown to its current RMB 2.5-billion level, funded by taxes from companies in the HTZ. In addition to the natural advantages of Dalian, such as low labor costs and a ready supply of educated workers, Wang said the HTZ offers special incentives but offered no details, even when pressed.

¶10. (U) Dalian Software Park is 'privately-owned' (it was started with government seed money) and located inside the HTZ. Over 450 companies are located in the park, about 42 percent of which are foreign-invested, and 37 of which are "Fortune 500" companies. When companies first move into the Park, many start out in the administration-run, low-rent "incubator building," before moving into their own building. U.S. companies located in the Software Park include Accenture, IBM, Oracle, and Cisco.

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